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SUBJECT: COMMITTEE ON FINANCIAL MARKETS MEETING, NOV 1973

REF: (A) CMF(73)8 (B) CMF(73)15 (C) CMF(73)16 D) CMF(73)18
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1. SUMMARY: COMMITTEE ON FINANCIAL MARKETS (CMF) MEETING 13-14 NOV 1973 HELD USUAL REVIEW OF RECENT DEVELOPMENTS IN DOMESTIC INTEREST RATES, OF IMPORTANT PLANS OR PROGRAMS FOR BASIC CHANGES IN FINANCIAL STRUCTURES AND INSTITUTIONAL ARRANGEMENTS, AND OF TRENDS IN INTERNATIONAL CAPITAL MARKETS. CONSEQUENCES OF OIL CRISIS RECEIVED CONSIDERABLE ATTENTION AND CONCERN, ALTHOUGH FEW WERE IN POSITION TO MAKE DEFINITIVE COMMENTS OR PROJECTIONS. SECRETARIAT WAS ASKED TO PREPARE PAPER ON BROAD IMPLICATIONS FOR FINANCIAL MARKETS OF OIL CRISIS. CMF WILL RECONSIDER AT NEXT MEETING THREE RECOMMENDATIONS FOR OECD COUNCIL DECISION DEVELOPED BY WORKING GROUP ON ADMISSION OF SECURITIES (REF A). NEXT CMF MEETING PLANNED FOR MARCH 4-5, 1974. END SUMMARY.

2.TREND IN DOMESTIC INTEREST RATES. U.S. DEL SUMMARIZED RECENT
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DOMESTIC TRENDS IN FINANCIAL MARKETS. HE NOTED THAT MOST MARKET RATES OF INTEREST IN U.S.--PARTICULARLY CERTAIN SHORT-TERM RATES--DROPPED QUITE SHARPLY IN LATE SUMMER AND EARLY FALL. THEY THEN REBOUNDED AFTER EARLY OCTOBER BUT HAVE REMAINED WELL BELOW

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EARLIER HIGHS, WITH SHORT-TERM RATES CONTINUING ABOVE LONG-TERM RATES. THESE MARKT DEVELOPMENTS LARGELY REFLECTED CHANGE IN MARKET EXPECTATIONS ABOUT TRENDS IN MONETARY POLICY, ECONOMIC GROWTH AND INFLATION AT TIME OF UPWARD RATE PRESSURES STEMMING FROM SUCH SPECIAL INFLUENCES AS FOREIGN CENTRAL BANK SALES OF TREASURY OBLIGATIONS. WITH CONSUMER SAVINGS FLOWS TO THRIFT IN-STITUTIONS REDUCED, MORTGAGE CREDIT HAS REMAINED IN SHORT SUPPLY AND NEW HOUSING HAS BEEN CURTAILED. UNDER ABOVE CIRCUMSTANCES OUTLOOK FOR FINANCIAL MARKETS GENERALLY OFFERED NO STRONG IMMEDIATE PROSPECT FOR EASING OF CREDIT DEMANDS, ESPCIALLY GIVEN LIKELY BUSINESS AND GOVERNMENT NEEDS FOR FUNDS. DELEGATES FROM JAPAN, FRANCE, NETHERLANDS, AND U.K. INDICATED THAT BOTH SHORT- AND LONG-TERM RATES HAD BEEN UNDER UPWARD PRESSURE AND THERE SEEMED TO BE LITTLE LIKELIHOOD OF EASING OVER NEAR TERM. AN EXCEPTION TO THIS GENERAL VIEW WAS CASE OF ITALY WHERE STRONG INTERVENTION BY CENTRAL BANK HAS BEEN TAKEN IN EFFORT TO STABILIZE MARKETS. ACTION BY U.K. ANNOUNCED ON NOV. 13 RAISED CENTRAL BANK MINIMUM LENDING RATE TO 13 PERCENT WHICH U.K. DEL FELT WOULD SOON PLACE ADDED UPWARD PRESSURE ON LONG-TERM AS WELL AS SHORT-TERM INTEREST RATES.

3. INTERNATIONAL CAPITAL MARKET. DISCUSSION OF EUROCURRENCY MARKET DEVELOPMENTS, APART FROM OILQUESTION (SEE BELOW), CONCENTRATED ON QUESTION OF EXPECTED DIRECTION OF INTEREST RATES, SIGNIFICANCE AND STABILITY OF TERM-LOAN MARKET, FUTURE OF EUROBOND MARKET, LUXEMBOURG STUDY OF COMPUTERIZED SECONDARY MARKET FACILITY (EUREX), AND PHENOMENON OF VARIOUS UNITS OF ACCOUNT INCLUDING NEW EURCO. SECRETARIAT SUGGESTED THAT EUROCURRENCY RATES WERE TENDING DOWNWARD AND THAT FROM PAST EXPERIENCE
THIS MIGHT BE TAKEN AS HARBINGER OF SIMILAR DOWNTURN IN NATIONAL MARKETS. IBRD OBSERVER DISPUTED THIS INTERPRETATION, ARGUING THAT EURODOLLAR RATES ARE AND WILL CONTINUE TO BE CLOSELY LINKED TO RATES IN U.S. AND THAT SUCH SLIGHT DOWNWARD MOVEMENT IN EURODOLLAR RATES AS HAS TAKEN PLACE WAS MAINLY DUE TO SOME NET DECLINE IN U.S. RATES OVER PAST COUPLE MONTHS AND STRENGTHENING OF DOLLAR IN EXCHANGE MARKETS WHICH HAS
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IMPROVED SUPPLY OF EUROCURRENCY FUNDS. SECRETARIAT AND IBRD CALLED ATTENTION TO RAPID INCREASE IN TERM LOANS ON WHICH TYPICAL MATURITIES NOW OFTEN OVER TEN YEARS. IBRD NOTED THAT SIZE OF MARKET IS NOW ABOUT FIVE TIMES THAT OF EUROBONDS, WITH ABOUT $9 BILLION LENT IN FOUR MONTHS JULY THROUGH OCT 1973 ALONE. EXTREME COMPETITION IN MARKET HAS BROUGHT DOWN SPREADS FRM ABOUT 1-1/2 PERCENT TO AS LITTLE AS 3/8 PERCENT FOR PRIME BORROWERS. THERE WAS SOME EVIDENCE THAT CREDITS WERE BEING EXTENDED ON HIGHER RISK INVESTMENTS AND THAT COMPETITIVE CONDITIONS MADE FOR SLOPPY REVIEW OF CREDITWORTHINESS OF PROJECTS AND BORROWING COUNTRIES, PARTICULARLY IN CASE OF WEAKER LDC'S. ONE DANGER OF THIS WAS THAT BORROWERS MIGHT FIND IT EXTREMELY DIFFIULT TO RE-FINANCE

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IN FUTURE IF EURODOLLAR AVAILABILITY DECREASED (E.G.,
HEAD OFFICE OF U.S. BANK MIGHT APPLY MORE CRITICAL LOAN ANALYSIS
THAN ITS BRANCH IN LONDON.) BANK OF ENGLAND REP COUNTERED THAT
THESE FEARS WERE EXAGGERATED. SAID THAT WEAKER LDC'S ONLY ACCOUNTED
FOR ABOUT 4 PERCENT OF TOTAL BORROWINGS AND THAT RISK TO
STABILITY OF MARKET WAS MINIMIZEDBY THIS FACT AND BY SHARING
OF LOAN RISKS AMONG NUMEROUS LENDERS. ALSO SUGGESTED THAT
EACH MEMBER OF LENDING SYNDICATE DOES NOT NEED TO GO THROUGH FULL
LOAN ANALYSIS. LATTER WAS RESPONSIBILITY OF SYNDICATE LEADER
WHO OFTEN HAS SPECIAL KNOWLEDGE OF BORROWER BASED ON LONG-
ESTABLISHED RELATIONSHIPS. ALSO STATED BANK OF ENGLAND KEEPING
CLOSE WATCH ON MARKET DEVELOPMENTS AND HAS AT TIMES NFORMALLY
CAUTIONED INDIVIDUAL BANKS ON THEIR LENDING PRACTICES. BANK
OF ENGLAND CONSIDERING PUBLISHING DATA ON ALL FOREIGN CURRENCY
CREDITS OF BANKS OPERATING IN U.K. (WHICH WOULD INCLUDE EURO-
CURRENCY LOANS AND OTHER CREDITS). LUXEMBOURG STOCK EXCHANGE REP
DESCRIBED FEASIBILITY STUDY FOR EUREX PROJECT FOR SECONDARY MARKET
IN EUROBONDS (SEE REF B). INDICATED FEASIBLITY STUDY SCHEDULED
TO BE FINISHED END NOV. BUT IMPLEMENTATION OF PROJECT MIGHT TAKE
YEARS. CLARIFIED THAT FEASIBILITY STUDY DID NOT INCLUDE QUESTION
OF FUTURE POTENTIAL OF EUROBOND MARKET. SECRETARIAT SUGGESTED
THAT FUTURE FOR EUROBONDS MAY BE DIM, PARTICULARLY ONCE U.S.
CAPITAL CONTROLS ARE REMOVED. THERE WAS BRIEF DISCUSSIONOF
UNIT OF ACCOUNT EXPERIMENTS INCLUDING EURCO (DESCRIBED IN
REF. B). WHILE SOME QUESTIONED WHETHER EURCO WAS GOING TO BE ANY
MORE SUCCESSFUL THAN OTHER TYPES OF UNITS OF ACCOUNT, EC,
BANK OF ENGLAND AND IBRD REPS THOUGHT IT WAS TOO EARLY TO TELL
AND NOTED THAT INVESTMENTS IN EURCO'S OVER RECENT PERIOD WOULD
HAVE EXPERIENCED RELATIVELY LESS EXCHANGE LOSS THAN WOULD HAVE
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BEEN THE CASE FOR OTHER UNITS OF ACCOUNT OR FOR SEVERAL
INDIVIDUALCURRENCIES.

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4. IMPACT OF PETROLEUM CISIS. CMF DISCUSSED QUESTION OF EFFECT OF OIL CRISIS ON BALANCE OF PAYMENTS TRENDS, GOVERNMENT BUDGETS AND CAPITAL MARKETS. U.K.N ITALY AND AUSTRALIA FELT THAT WHILE TRADE BALANCES OF OECD COUNTRIES WOULD DETERIORATE AS A RESULT OF INCREASED OIL IMPORT BILL, THERE WOULD BE COMPENSATORY FLOW OF CAPITAL FRM ARAB COUNTRIES AS OIL PRODUCERS SEARCHED FOR INVESTMENT OUTLETS. U.K. SUGGESTED THAT WITH RECENT INCREASE IN BANK RATES HIS COUNTRY IN GOOD POSITION TO BID FOR ARAB FUNDS. SOME OTHERS, PARTICULARLY DUTCH, STRESSED NEGATIVE EFFECT OIL CRISIS ON BALANCE OF PAYMENTS AND GOVERNMENT REVENUS. U.S. AND CANADA NOTED THAT NET EFFECT ON GOVERNMENT REVENUES NEED NOT BE NEGATIVE IF GOVERNMENTS CHOSE TO USE INCREASED TAXES ON PETROLEUM PRODUCTS IN THEIR ENERGY PROGRAMS. SECRETARIAT AND OTHERS POINTED TO POSSIBLE NEED FOR COUNTRIES TO LIBERALIZE CAPITAL INFLOW RESTRICTIONS SO AS TO PERMT CAPITAL INFLOW TO OFFSET POSSIBLE DETERIORATION BALANCE OF PAYMENTS CURRENT ACCOUNTS RESULTING FROM PETROLEUM DEVELOPMENTS. CMF REQUESTED SECRETARIAT TO PREPARE NOTE ON IMPLICATIONS PETROLEUM PROBLEM FOR FUTURE DEVELOPMENTS INTERNATIONAL AND DOMESTIC FINANCIAL MARKETS.

5. CHANG IN FINANCIAL STRUCTURES. U.S. DEL SUMMARIZED PROVISION OF
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FINANCIAL INSTITUTIONS ACT OF 1973. CMF PRIMARILY INTERESTED POSSIBLE IMPLICATIONS FOR GENERAL LEVEL OF INTEREST RATES ON ASSETS AND LIABILITIES IN U.S. AND LOGIC OF MAKING MORTGAGE INTEREST TAX CREDIT AVAILABLE TO LENDERS RATHER THA BORROWERS. FEELING WAS THAT PROPOSALS WERE IN LINE WITH GENERAL THINKING OF CMF TO INTEGRATE DOMESTIC FINANCIAL MARKETS. IN RESPONSE TO QUESTION ABOUT PURPOSE OF SPECIAL TREASURY STUDY ON CAPITAL MARKETS, U.S. DEL NOTED THIS WAS GENERAL INQUIRY AND HAD NO SPECIFIC CONNECTION WITH PROVISIONS PROPOSED IN FIANCIALINSTITUTIONS ACT OF 1973. U.K. TREASURY EXPERT COMMENTED ON STATUS OF PAGE COMMITTEE REPORT TO REVIEW NATIONAL SAVINGS (REF C), NOTING THAT ONLY SECOND RECOMMENDATION (RESTRUCTURE OF TRUSTEE SAVINGS BANKS) WAS BEING ACTIVELY CONSIDERED FOR POSSIBLE IMPLEMENTATION, WITH MAJOR QESTION BEING MODE OF IMPLEMENTATION.

6. QUESTIONNAIRE ON INTERNATIONAL SECURITY ISSUES. CMF HELD PRELIMINARY DISCUSSION OF DRAFT TEXT OF RESULTS OF QUESTIONNAIRE (REF D) AND ITS IMPLICATIONS; E.G., WHETHER AND HOW TO ENSURE BETTER INFORMATION ON ISSUES IN INTERNATIONAL MARKET. SECRTARIAT WAS DIRECTED TO REDRAFT DOCUMENT, TAKING INTO ACCOUNT COMMENTS

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AND CORRECTIONS TO BE SUBMITTED BY DELS, FOR DISCUSSION AT NEXT MEETING. LATTER WILL BE CENTERED AROUND SPECIFIC LIST OF ISSUES TO BE DRAWN UP BY SECRETARIAT. ISSUES INCLUDE APPROPRIATE FORM OF COMMUNICATION OF SUBJECT MATTER TO OED COUNCIL.

7. ADMISSION OF SECURITIES TO STOCK EXCHANGES. CMF DID NOT ADOPT ANY OF THE THREE DRAFT RECOMMENDATIONS IN REF A ANNEXES. DIFFICULTIES RANGED FROM LACK OF INSTRUCTIONS ON PART OF SOME DELS ABOUT POSITION TO BE TAKEN, TO SOME SPECIFIC OBJECTIONS ABOUT DRAFT LANGUAGE. U.KM EMPHASIZED NEED TO TAKE INTO ACCOUNT EXCHANGE CONTROL RESTRICTIONS AND DUTIES OF GOVERNMENTS AS CONTRASTED WITH RESPONSIBILITIES OF STOCK EXCHANGES, WITH SPECIAL REFERENCE TO PROBLEMS ASSOCIATED WITH UNLISTED SECURITIES OVER WHICH STOCK EXCHANGES LACKED JURISDCITION AND WHERE GOVERNMENT HESIANT TO PLEDGE RESPONSIBILITY. SEVERAL COUNTRIES RELUCTANT TO ACT ON DRAFT RECOMMENDATIONS CONCERNING DISCLOSURE REQUIREMENTS UNTIL WORKING PARTY SUBMITS PROPOSALS ON RULES FOR MINIMUM DISCLOSURE AND RELATED PROCEDURES. SOME DELS, INCLUDING JAPAN, ALSO HAD PROBLEMS WITH IMPLICATIONS OF WORKING PARTY RCOMMENDATION THAT LISTED SECURITIES ARE NOT NECESSARILY OF HIGHER QUALITY THAN UNLISTED SECURITIES. CMF ASKED SECRETARIAT AND WORKING PARTY
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TO REVIEW LANGUAGE OF DRAFT RECOMMENDATIONS IN LIGHT OF COMMENTS MADE, FOR CONSIDERATION AT NEXT MEETING, IF FEASIBLE, TOGETHER WITH WORKING ARTY DRAFT PROPOSALS ON MINIMUM DISCLOSURE RULES. IN RESPONSE TO U.S. DEL QUESTION WHETHER TO CHANGE NAME OF WORKING PARTY ON ADMISSION OF SECURITIES TO REFLECT BROADER MANDATE, CHAIRMAN SUGGESTED DELAYING CONSIDERATION UNTIL CMF REVIEWS FUTURE WORK PROGRAM OF WORKING PARTIES.

8.REPORT ON STATISTICS. SECRETARIAT DIRECTED TO RECAST REF E IN FORM OF SHORT CMF REPORT TO OECD COUNCIL, FOR CONSIDERATION AT NEXT MEETING.

9. NEXT MEETING AND AGENDA. CHAIRMAN INDICATED THAT CMF AGENDA, AT NEXT MEETING MARCH 4-5, 1974, WOULD INCLUDE FOLLOWING ITEMS IN ADDITION TO THOSE NOTED ABOVE: (A) TOUR D'HORIZON ON STRUCTURAL DEVELOPMENTS TOGETHER WITH DISCUSSION ON EVOLVING RELATIONSHIPS BETWEEN SAVINGS BANKS AND COMMERCIAL BANKS, WITH SWEDEN TO SUBMIT REPORT ON SUBJECT; (B) REVIEW PROGRAMS OF CMF WORKING PARTIES, INCLUDING GROUPS ON HOSING FINANCE AND MUTUAL FUND RULES, AND (C) CMF WORK PROGRAM FOR NEXT 18 MONTHS. MEMBER COUNTRIES ARE INVITED TO SUBMIT WRITTEN SUGGESTIONS BEFORE YEAR-END TO SECRETARIAT OR CMF CHAIRMAN.
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